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SUBJECT: NIGERIA-CENTRAL BANK REFORMS AND CONTINUING
CHALLENGES-UNDER SECRETARY JEFFERY'S CENTRAL BANK MEETING

REF: A. ABUJA 372
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SENSITIVE BUT UNCLASSIFIED - PLEASE HANDLE ACCORDINGLY

[1](#)1. (SBU) Summary. Central Bank of Nigeria (CBN) Deputy Governors briefed Under Secretary for Economic Affairs Reuben Jeffery on Bank priorities and the Nigerian economy during his visit to Abuja on July 25. Officials said the CBN continues to work towards achieving its core mandate of maintaining price stability despite challenges posed by rising global food and energy prices, and the effect of fiscal expansion. Recent reforms in the banking sector have increased retail lending to consumers, and improved the payments system. Officials requested USAID assistance in drafting a microfinance strategy. Despite progress obstacles remain, such as a regulation standardizing bank accounting practices was suspended and a government investigation into the African Finance Corporation (AFC) continues although the CBN dismisses it as politically motivated. Further, officials confirmed the CBN will maintain restrictions on foreign ownership of Nigerian banks for the foreseeable future, and vested interests may stymie further reforms by the activist CBN Governor. End Summary.

[1](#)2. (U) On July 25, a panel of CBN Deputy Governors briefed visiting Under Secretary Reuben Jeffery, the Ambassador and Embassy staff on its recent reforms and ongoing challenges. The CBN panel was led by Deputy Governor (DG) for Corporate Services Ernest Ebi, DG for Policy Sarah Alade, and DG for Operations Suleiman Barau.

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Macroeconomic Assessment

[1](#)3. (SBU) Officials confirmed that Nigeria was not immune to rising global food and energy prices and that the CBN was grappling with inflation. DG Alade said the June 2008 12 percent inflation rate represented the highest level reached in two years. Food prices had contributed to the increase: in June, food inflation stood at 18 percent while core inflation was 3.6 percent. Adequate rainfall and a good harvest in 2008 could result in inflation falling to upper single digits by year end, Alade contended.

[1](#)4. (SBU) The CBN's foreign operations department reported that foreign reserves stood at \$61.5 billion, 89.2 percent of which were in U.S. dollars with the rest in other major currencies. DG Ebi noted that other macroeconomic indicators were under control and that the Monetary Policy Committee (MPC) would not hesitate to intervene to maintain price stability.

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Financial Sector Strategy 2020

[1](#)5. (SBU) Per DG Barau, a GON goal - through its Financial Sector

Strategy (FSS) 2020 - is to make Nigeria the financial hub of Africa. This objective coincides with another GON objective to develop Nigeria into one of the top twenty economies in the world by the year 2020. To support this goal, the GON has drafted eleven related strategy documents, with active participation by the IMF and the World Bank, and presented them to President Yar'Adua in early July 2008 for his consideration. Concurrently, the GON envisions establishing a Financial Services Authority with the required regulatory framework. DG Barau requested USAID assistance in drafting a microfinance strategy to support the process. As an additional element of the strategy, the CBN will hold a competition to select a city to become Nigeria's financial hub. The winner will receive GON assistance in building the required infrastructure.

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Payment System Reform

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16. (SBU) Deputy Governors highlighted reforms of the past four years that developed confidence in the banking sector and increased deposit accounts. An effort to license microfinance institutions was aimed at reaching the "unbanked" in rural areas. Despite these reforms, Nigeria remains predominantly a cash economy, and the CBN has further plans to reform the payments system by encouraging electronic payment channels and checking accounts. The CBN is encouraging GON agencies to use electronic payment channels for salary administration and payment of taxes. In addition, the CBN Committee of Governors is considering a proposal that all payments above 10 million naira (\$85,470) be made by check or electronic payment.

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Credit Administration

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17. (SBU) DG Ebi claimed that consumer credit within the economy had increased greatly since the first phase banking sector reforms in December 2005. Banks now lend for purchases of cars and household equipment although further success is hampered by the absence of a platform for banks to obtain credit information on loan applicants, which prevents banks from accurately pricing their risks to avoid loan defaults. A National Identity Card Scheme and a Credit Bureau would improve the situation and the GON is moving to create them. DG Ebi said the CBN plans to regulate Credit Bureaus which should increase bank lending.

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Suspension of Uniform Accounting Year

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18. (SBU) On July 24, CBN Governor Soludo postponed a new policy to institute a standardized accounting year for banks which would have begun in December 2008. Its implementation is now scheduled for December 2009. DG Ebi explained the action was necessary because banks had attempted to increase deposits by offering high interest rates on deposits (some as high as 19 percent) leading to interest rates on loans as high as 30 percent in order to avoid asset-liability mismatch. (Comment: Some banks swapped deposits in order to give the impression that their deposit base appeared higher; however, the new regulation makes this impossible since it would implement a uniform year end. Therefore, these same banks needed to increase their deposits and engaged in aggressive deposit interest rate offers to improve their base before December 2008. End Comment.) The high lending rates increased the cost of funds to the real sector and fuelled inflation. The CBN felt compelled therefore to "step in to bring sanity to the banking sector and also to maintain price stability."

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African Finance Corporation

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19. (SBU) DG Ebi declined to comment on the report by the Office of the Secretary to the Government Investigation Committee on the operations of the AFC (Reftel B) because it has yet to be presented to President Yar'Adua, but, noted the CBN will make a statement following the submission. He contended that the AFC investigation was a political maneuver and not based on facts.

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Foreign Bank Ownership

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¶10. (SBU) DG Ebi stressed that foreign banks could apply for licenses to establish operations in Nigeria once they met the 25 billion naira (\$214 million) minimum capital requirement. DG Alade agreed that more competition would be good for the sector but warned that foreign banks would not be allowed to acquire existing local banks because "at this level of Nigeria's development we only need banks that will focus on the domestic economy." She said in the longer term the CBN will likely loosen the restrictions on Acquisitions and Mergers.

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Comment

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¶11. (SBU) Financial sector reforms begun in June 2004 have had positive effects on the economy. Banks are lending more than in the past and some evidence indicates a middle class may be emerging. The banks are developing new products and competition in the industry with accompanying innovations has led to increased customer satisfaction. Despite these successes, much more needs to be done to effectively regulate the banking sector and better manage price stability. CBN efforts in that direction may be hampered by the current Governor's controversial activism which may not sit well with vested interests. End Comment.

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